United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-5039

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

In re

REA HOLDING CORPORATION
THE EXPRESS COMPANY
REA EXPRESS, INC., f/k/a
Railway Express Agency, Inc.
REXCO SUPPLY CORPORATION,

Bankrupts.

MATTHEW E. MANNING, ANTHONY SATRIANO, DANIEL S. GILHULY, VINCENT PONTILLO, WILLIAM R. WEGL, EDMUND F. NOVITSKI, EDWARD J. COX, ANTHONY J. JANUZZI, CHARLES F. McGOVERN and JAMES J. KILCOYNE,

Creditors-Appellants,

BROTHERHOOD OF RAILWAY, AIRLINE AND STEAMSHIP CLERKS, FREIGHT HANDLERS, EXPRESS AND STATION EMPLOYEES,

Intervenor,

v.

C. ORVIS SOWERWINE, Trustee in Bankruptcy,

Appellee.

On Appeal From the United States District Court
For The Southern District of New York

BRIEF OF APPELLEE-TRUSTEE

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Dated: January 31, 1977

ERRATA SHEET - BRIEF OF APPELLEE-TRUSTEE
Dated: January 31, 1977

PAGE	LOCATION	CORRECTION
i	Point IV	delete "BY THE TRUSTEE"
2	line 18	add a comma at end of line
3	line 3	change "was" to "were" in both places
4	line 16	insert "Intervenor" before "Brotherhood"
6	line 2	add an "s" to "bond"
7	line 13	add ", Inc." after "U.S.A."
9	line 14	delete "that"
10	line 24	add an "a" to "yers" between "e" and "r"
13	line 6	should read "REAEMCO"
13	line 18	add a comma after "that"
13	line 20	delete "that" and add a comma after "discharged"
13	line 23	add a comma after "dollars"
14	line 5	add an "n" to the "a" before "agents," and delete "s" from "agents"
14	line 7	add a comma after "Court"
14	line 12	add a comma after "Court" and after "exhibit"
17	line 7	delete "i.e."
18	line 8	close space in "MacMahon"
18	line 16	delete "the purpose of"
18	line 18	change "would" to "to"

18	line 23	change "that" to "for" and "would" to "to"
20	line 20	delete second "t" from "Interventor"
21	line 9	delete comma after "court" and change period after "below" to a comma
22	line 17	delete "1)"
22	line 2	should read "Friou & Koch"
22	line 3	add a comma after "counsel"
22	line 9	change first "the" to "to"
22	line 19	should read "specifically"
22	line 21	delete "of"
25	line 4	"hve" should read "have"
26	line 24	add an "s" at end of "subject"
29	line 7	change "82" to "9"
30	line 6	change "principals" to "principles"
31	line 11 & 16	change periods to question marks
31	line 19	change "however" to "therefore"
32	line 19	add a comma after "Lastly"
34	line 6	should read "Appellants"
34	line 14	should read "value: what"
35	line 17	delete comma after "two"
35	line 19	insert apostrophe after "r" in "Debtors"
36	line 1	insert second "t" in "testimony"
38	line 7 of 2nd quotation	reverse "i" and "r" to spell "fairly"
41	line 10 of quotation	add "al" to "dismiss"

43	line 10	change "ten" to "nine"
45	line 2 of heading	delete "BY THE TRUSTEE"
47	line 7 of text	should read "two of his"
48	line 8	delete "1" from "represents"
48	line 18	should read "a manner bordering"
48	line 19	insert "situation" after "different"
50	line 2	insert "d" in "Judge"
50	line 5	should read "bears"
52	line 5	delete "both 1 and 2"
53	line 3 of text	insert comma after "Trustee"
53	line 15 of text	change "were" to "is"

TABLE OF CONTENTS

TABLE OF CASES

TABLE OF STATUTES AND AUTHORITIES

STATEMENT OF ISSUES

1. Whether the Chapter X petition was filed in good faith under general equity principles.

2. Whether the Chapter X petition was filed in good faith in that it was unreasonable to expect that a plan of reorganization could be effected.

3. Whether the Chapter X petition was filed in good faith in that it appeared that the interest of creditors would be best subserved in the pending bankruptcy proceeding.

4. Whether the Appellants and the Intervenor were accorded a fair hearing on their Chapter X petition.

5. Whether the issue of the Trustee's alleged conflict of interest was ever properly raised.

6. Whether the Appellants' motion for a receiver should have been granted.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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In the Matter of :

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APPELLEE'S BRIEF

PRELIMINARY STATEMENT

On February 18, 1975 REA Holding Corporation, The Express Company, Inc., REA Express, Inc., f/k/a Railway Express Agency, Inc. and Rexco Supply Corporation (the "Bankrupts") filed petitions for arrangements under Chapter XI of the Bankruptcy Act. The matter was referred to Honorable John J.Galgay, Bankruptcy Judge. On November 6, 1975, the Bankrupts were adjudicated bankrupts. On November 7, 1975, C. Crvis Sowerwine qualified as Trustee in Bankruptcy of all Bankrupts (the "Appellee"). On September 22, 1976, ten creditors who were former employees of the Bankrupts ("Appellants") filed a petition for reorganization under Chapter X of the Bankruptcy Act. Appellants also moved for the appointment of a Receiver to conduct the business of the Bankrupt and take charge of its property. Both matters were

assigned to the Honorable Lloyd F. MacMahon, District Judge, who referred the matters to Bankruptcy Judge Galgay to hear and report on the issue of whether the petition for reorganization under Chapter X of the Bankruptcy Act was filed in good faith. Judge Galgay conducted a hearing and reported that the Chapter X petition was not filed in good faith and filed a report containing his written findings of fact and conclusions of law on September 28, 1976. He also ordered that his report be submitted to Judge MacMahon for hearing and approval on September 29, 1976. After such hearing and on September 30, 1976, Judge MacMahon handed down an opinion adopting the findings of fact and conclusions of law of the Bankruptcy Judge in all respects and specifically found that the petition under Chapter X was not filed in good faith. From this order of September 30, 1976, the petitioners have appealed to this Court.

Subsequent to the filing of the notice of appeal to this Court, the Trustee moved to disqualify Appellants' counsel from further representation of Appellants on the grounds that inter alia, Appellants' counsel had represented the Trustee with respect to all matters involved in this appeal and further, was still acting as Trustee's special counsel. The Trustee contended that such conduct violated the provisions of the Code of Professional Responsibility of the American Bar Association and was conduct unbecoming a member of the bar as that term has been defined by this Court and the District Court.

During the hearings on such disqualification of Appellants' counsel, a Temporary Restraining Order and Preliminary Injunction was signed and was in effect. While the Appellants' counsel were so restrained and enjoined, the Brotherhood of Railway Airline and Steamship Clerks, Freight Handlers, Express and Station Employees ("Intervenor") moved to intervene and filed a brief on behalf of Appellants. Subsequently, the provisions of the Temporary Restraining Order were extended by Stipulation of Appellants' counsel and the Bankruptcy Judge excluded from its provisions any restraint on appellant's counsel filing a brief in this appeal and arguing this appeal. Trustee-Appellee's brief is in answer to both the brief of Appellants and the brief of Intervenor.

STATEMENT OF FACTS.

We will refer to references found in Appellants' appendix as "(App. App. p____)"; those in Intervenor's appendix as "(Int. App. p____)"; and those in the Appellee-Trustee's appendix as "(Trustee's App. p.____)".

Prior to the filing of petitions for arrangements under Chapter XI of the Bankruptcy Act on February 18, 1975, the Bankrupts had been engaged in the business of surface and air express shipments throughout the United States under the regulatory jurisdiction of the Interstate Commerce Commission ("ICC") and the Civil Aeronautics Board ("CAB"). They were also engaged in

international transportation services and custom brokerage.

On February 18, 1975 Judge Galgay, who has been in charge of these proceedings from their inception to the present, signed an order which permitted the Bankrupts to continue to operate their businesses as Debtors-In-Possession. An official Creditors Committee was confirmed by the Bankruptcy Court on April 8, 1975. During the Debtor-in-Possession period, the Bankrupts met continuously with the Official Creditors Committee and continued their operations. The Bankrupts effected various substantial economies and efficiencies in their operations which they and the creditors believed would ultimately result in their becoming profitable operations. The Bankrupts had lost money every year for over thirty years except during calendar 1974.

In connection with their economy measures, the Bankrupts moved to reject their contract with the Brotherhood of Railway and Airline Clerks ("BRAC"). While this motion was pending, the debtors paid the BRAC employees at only 90% of their then going wage and did not pay the BRAC employees any vacation pay or holiday pay. The Bankrupts' motion to reject the BRAC contract was ultimately granted by the District Court. This Court affirmed, but sent back to the District Court for trial the question as to whether the BRAC contract was onerous and burdensome. Subsequent to the date of the adjudication of the Bankrupts, the District Court found the BRAC contract to be onerous and burdensome.

The claims of the BRAC employees for vacation pay, holiday pay and 10% of their wages during the Chapter XI proceeding will be referred to below at a more appropriate point in this narrative. At present, it is pertinent only for the reason that the creditors who signed this petition for reorganization under Chapter X of the Bankruptcy Act are all BRAC employees who assert claims by virtue of the rejection of such contract.

On November 5, 1975 a hearing was held before the Bankruptcy Court with respect to the operations of the Debtors-in-Possession from February 18, 1975 to November 5, 1975. Mr. Robert Roth, a member of the accounting firm of Price Waterhouse & Company, accountants for the Debtors-in-Possession, testified at that hearing that despite the substantial economies which had been effected, the losses suffered by the Debtors-in-Possession (Bankrupts) from February 18, 1975, (the commencement of the Chapter XI proceeding), through September 28, 1975 had been approximately $15,790,000. Mr. Roth forecast that for the months of October, November and December 1975, the Debtors-in-Possession would lose an additional $5,681,000. He also estimated that the total administration expenses incurred but unpaid during the Chapter XI proceeding, was in the neighborhood of $19,000,000. (If the claims of the BRAC employees were disallowed, this $19,000,000 would be reduced to about $10,000,000). On November 6, 1975, the debtors (Bankrupts) requested that they be adjudicated bankrupts because they had insufficient funds to meet their payrolls. On November 6, 1975, an order was entered by the Bankruptcy Court adjudicating all four Debtors-in-Posse-

ession bankrupts. On November 7, 1975, C. Orvis Sowerwine, duly qualified as Trustee ("Appellee") by filing his bond. The bonds were approved by order of the Bankruptcy Court dated November 7, 1975.

Commencing with his qualification on November 7, 1975 and continuing up until the present date, the Trustee, as required under Section 47(a) of the Bankruptcy Act and Rule 605(a) of the Rules of Bankruptcy Procedure, has been expeditiously collecting and reducing to money all of the property of the bankrupt estates. Substantially all of the terminals have been disposed of. All of the bankrupts' rolling stock and all other operating assets have been sold. The operating authorities consisting of the aggregate rights to haul freight as a common carrier in interstate and intrastate commerce have also been sold. The successful bidder is prosecuting approval of its purchase before the Interstate Commerce Commission (ICC), while an unsuccessful bidder, Reaemco, Inc., described in Appellants' Brief p. 2 as a corporation formed by and for the former employees of REA Express, Inc. one of the Bankrupts) has appealed the decision to the District Court. (App Brief p. 5). No decision has been reached because the District Court has stated it will not consider that appeal until this Court rules on the Chapter X petition, (App. Brief p. 6). A few isolated parcels of real estate remain unsold, and the Trustee is, of course, pursuing various claims on behalf of the bankrupt estate. Indeed, at the present time, the Trustee has on deposit, in interest bearing

accounts, in various authorized banks, approximately seven million dollars.

Pursuant to an order dated May 24, 1976, a hearing was held at the Bankruptcy Court on June 23, 24, 25, and 30 and on July 1, 8 and 9, 1976 on an application by the Trustee to dispose of all of the surface operating authorities of the bankrupt REA Express, Inc. together with other related assets such as customer lists, trade names and trademarks (the "Alltrans hearings", so named in this brief because Alltrans was the successful bidder). The Chapter X petition which is the subject matter of this appeal is intimately connected with the Alltrans hearings.

The two principal bidders for the surface operating authorities of the bankrupt were Alltrans Express - U.S.A. (Alltrans) and REAEMCO, Inc. (REAEMCO). The Alltrans offer as amended during the course of the hearing, was that Alltrans would pay the Bankrupts' 2.5 million dollars in cash upon ICC approval of the temporary transfer of the Bankrupts' operating authorities to it. addition, until the ICC denied Alltrans permanent approva. or if the ICC granted Alltrans permanent approval, Alltrans would pay to the bankrupt estate a percentage of gross revenues generated from the use of these operating authorities over a ten year period. It was anticipated that six to seven years would be required before final determination of the permanent transfer of REA's operating authority to Alltrans would be received from the ICC. In addition, Alltrans and its parent

Thomas Nationwide Transport, Ltd. (the latter having consolidated assets of over $190,000,000) guaranteed payment of at least $9,569,000 to such bankrupt estate if such regulatory approval was obtained.

REAEMCO was a corporation organized for the express purpose of acquiring the rights of the Bankrupt. (App. App. p. 2). It then had and at least up to the time of Judge MacMahon's decision still had no assets whatsoever. The stock of REAEMCO was to be ultimately owned by a voting trust whose voting trust certificates were to be beneficially owned by BRAC members who were former employees of the bankrupt. (Id. p. 2). The REAEMCO proposal was based on the assumption that if the REAEMCO bid were the successful bid, REAEMCO would commence a new express business and develop it within three years to a point where its volume would exceed all but the three largest transportation companies in the United States. REAEMCO offered a larger percentage of its revenues to the bankrupt estate than Alltrans, and a larger guarantee of minimum payments, provided, of course, that it would succeed to the point where it could pay such sums. The REAEMCO proposal contemplated that no monies whatsoever would be paid to the bankrupt estate upon REAEMCO becoming the successful bidder (in contrast to the $2.5 million of Alltrans) but that the former BRAC employees would waive their Chapter XI administration claims. At the time of the Alltrans hearings virtually no valid waivers had been obtained from any of the approximately

8,000 former employees. The REAEMCO proposal appears in Trustee's appendix pp. 1-80.

At the hearing the Trustee called Arthur Olick, Esq., former attorney for the Bankrupts (and Debtors-In-Possession) who personally handled the litigation with respect to the rejection of the BRAC contract both up to this Court and subsequently before the District Court on the remand, at which time Mr. Olick acted as special counsel to the Trustee. Mr. Olick testified that in his opinion the Chapter XI administration claims of the BRAC employees would be disallowed, a conclusion with which the Trustee's counsel completely concurred. Such opinion appears in Trustee's Appendix pp. 81-82. The reason for such conclusion was that when the Second Circuit upheld the rejection of the BRAC contract, that the claims of the BRAC employees for holiday and vacation pay and the additional 10% of salary became void because there was no contract to support them, and the employees had nevertheless continued to work and accept whatever salaries were being paid by the then debtor-in-possession. Therefore the value of the waiver of such Chapter XI administration claims of the employees was zero.

F. Ralph Nogg, the principal witness for REAEMCO, a consultant in the transportation industry, was called as a witness by REAEMCO and testified that, in his opinion, the REAEMCO projections were reasonable and could be met and that he would run the REAEMCO operation to assure its success. He

further testified that in his opinion $3,000,000 of start up capital would be adequate.

Mr. Nogg's testimony commenced on the morning of June 24, 1976, and occupied virtually the entire day. On June 25, 1976, Mr. Nogg again took the witness stand and testified for the entire day. At the next hearing on June 30, 1976, the hearing began at 1 o'clock and Mr. Nogg testified for the balance of the day. At the next hearing on July 1, 1976, Mr. Nogg testified for most of the morning. At the final hearing on July 9, 1976, Mr. Nogg again testified for most of the morning and a short part of the afternoon.

Mr. Nogg testified extensively as to how the reorganized express business would operate under the REAMECO plan, and indeed, Mr. Nogg, himself a former Chapter X Trustee, testified that the REAEMCO proposal was in effect a reorganization. (Trustee's App. p. 115). He testified how the company would be organized into divisions, i.e. an express division for small shipments, (Trustee's App., pp. 86-90), a special commodities division based on the bankrupt's REXCO division, (Trustee's App. pp. 83-84), an air express system, (Trustee's App. pp.86-87), a system of trailers on railroad flatcars, (Trustee's App. pp. 85-86). As to the employees, Mr. Nogg testified how many would be hired during the first six months, during the first year and for each of the two yers thereafter (Trustee's App. pp. 91-92). He testified as to how the employees would contribute ten percent

(10%) of their salaries to the company, (Trustee's App. pp. 70) and how those contributions would build up capital. Mr. Nogg produced a chart to demonstrate (REAMECO's exhibit 11) how employees would share in all of the company's profits over five percent and the extent of the employees estimated investments in the company, (Trustee's App. pp. 91-92). He testified as to the salaries of the operating officers. (Trustee's App. 113-114). He testified how the company would hire salesmen and agents who had already been recruited and what commissions they could receive, i.e. a salesman would receive a 2% commission on traffic going out of his district, and a 1% commission on traffic coming into his district (Trustee's App. p. 94). Moreover, Mr. Nogg testified as to the acquisition of the operating assets. He testified that freight could be moved by trucks, railroads, planes and ships in a system for "intermodal transportation" (Trustee's App. p. 87). He testified that trucks could be rented, that in some cases the drivers would own their own tractors and just use the company's rented trailers. He testified as to the number of terminals which could be opened within thirty (30) days, the number which would be opened between thirty (30) and sixty (60) days and the number to be opened within one hundred and eighty (180) days, (Trustee's App. pp. 102, 103).

He testified how the company's employees were willing to buy their own equipment to use for delivery of shipments which had arrived at the terminal (Trustee's App. pp. 96-97),

and how in other places the company would engage the services of cartage companies. Furthermore, Mr. Nogg discussed the financing of the company and how different methods were available from different sources to raise capital without having any hard assets to secure such loans. Also, Mr. Nogg discussed the projected revenues from the different parts of the company's business and the growth of total projected revenues for the company, (Trustee's App. pp.98-100) and presented a chart as an exhibit to demonstrate each one of his projections. (REAMECO Exhibit 12). He compared the projected growth in revenues to the actual revenues the bankrupt had generated in the last ten years to show how much more successful his proposal would be, (Trustee's App. pp. 100-01) and presented a chart as an exhibit to dramatize his testimony. (REAMECO Exhibit 13). He showed how the profits would be used for repayment of creditors, repayment of loans, etc., (Trustee's App. p. 97) and made specific estimates of how long it would take to pay each of these creditor classifications, and showed that there was a large equity left over for shareholders of the Bankrupt REA Holding Corp. over and above the profits to be paid to the employees.

In summary, Mr. Nogg in his approximate three and one half days of testimony gave a thoroughly detailed description of every phase of the proposed employee operation of the operating rights of the Bankrupts, (the then only unsold assets) and even

testified that he considered this purchase by REAEMCO to be a reorganization of the Bankrupt. (Trustee's App. p. 115). We have summarized Mr. Nogg's testimony because the principal error asserted by Appellants and Intervenor was in the Bankruptcy Court's failure to have Mr. Nogg testify all over again.

The cross examination of REAMECO's witnesses showed that REAEMCO not only did not have one penny of working capital to begin with but that it had no firm commitment from anyone to put up even a penny. (Trustee's App. pp. 104, 105, 109). Moreover, Mr. Nogg testified that attempts to raise the money from the former BRAC employees had resulted only in pledges of approximately $300,000, no cash.

The testimony further showed that the REAEMCO proposal was based on purchasing the stock of the bankrupt REA Express, Inc., obtaining a discharge from the Bankruptcy Court of all provable claims against it and then having the Trustee "quit-claim" (Trustee's App. pp. 116), the operating rights to the former REA Express, Inc. The testimony indicated that even if such a scheme were feasible and the provable claims against REA Express, Inc. discharged that the non-dischargable claims consisting of tax claims would exceed 8 million dollars and this 8 million dollar liability, coupled with the guarantee of REAMECO to the Trustee of over 10 million dollars would put REAEMCO in a position where it was commencing its operation with a minimum of an $18 million negative net worth, - a fact which would render ICC

approval of the transfer of the operating rights to REAEMCO virtually impossible. Moreover, the testimony indicated that this scheme might result in placing the $7 million in the hands of the Trustee at risk because REAEMCO alternatively proposed that it merely operate the rights as a agents of the Trustee. (Trustee's App. pp. 106).

The Bankruptcy Court in an opinion dated July 16, 1976 held that this REAEMCO proposal failed to seriously compare with the Alltrans proposal and approved the Alltrans proposal. (App. App. pp.14-31).

During the course of the hearing, the Appellant's attorneys offered to the Court as an exhibit the present petition for reorganization under Chapter X of the Bankruptcy Act on behalf of ten former employees of the bankrupt who were BRAC members having alleged claims approximating $22,000.

Counsel for the Trustee took the position that the Chapter X petition handed to the Court was a nullity because (1) it failed to comply with the express requirements of Local Rule X (2a) which provides that the filing of such a petition must be with the Clerk of the District Court, and (2) because of the further express statutory requirement of §132 of the Bankruptcy Act which requires the filing of a petition under Chapter X of the Bankruptcy Act to be accompanied by a payment to the

Clerk of the Court of the requisite filing fee. Neither condition had been complied with. Appellants' counsel took the position that he had orally "tendered" the filing fee and the requisite copies. Appellants' counsel and the petitioning creditors acknowledged at the hearing that they did not intend the offer of the Chapter X petition to be a filing under Chapter X because a filing would have the consequence of an automatic stay, (Trustee's App. p. 120).

Judge Galgay in his decision of July 16, 1976 commenting on the Chapter X proposal found inter alia as follows:

> "5. That the attorneys for the Trustee and the attorneys for REAEMCO have stipulated that if a proper petition for reorganization under Chapter X of the Bankruptcy Act was or is properly filed before this Court, that the entire record made of these hearings including but not limited to the order fixing the hearing, the application for such order and exhibits annexed, the stenographic transcript of all hearings and the exhibits introduced by all parties, the memorandum decision of this court and this order, shall constitute the entire record in support of such petition by such petitioning creditors;
>
> 6. That it would be adverse to the interests of the bankrupt estate that any assets of the bankrupt presently in the hands of the Trustee be put at risk to enable the Trustee to continue to expand an express business, other than the continued operation of the REXCO division by the Trustee pending final disposition of the Property."

The position taken by the Wisehart firm was that the sale of the operating rights to Alltrans was a liquidation of the rights while a sale of the operating rights to REAEMCO was effectively a reorganization of the company and therefore if the Court did not award the operating rights to REAEMCO then REAEMCO would file the Chapter X but not otherwise.

REAEMCO, Inc. appealed the Court's decision of July 16, 1976 approving the disposition of the operating autorities to Alltrans. That appeal was assigned, on an expedited basis, to Judge Henry F. Werker of this Court. Following submission of all papers on the appeal to Judge Werker and the argument of the appeal (which was heard on Saturday August 28, 1976) counsel for REAEMCO then wrote Judge Werker a letter on or about September 3, 1976 stating that if the only problem with their proposed Chapter X petition was failure to either file the requisite copies with the clerk and pay the filing fee, Judge Werker should tell them and they would comply. When Judge Werker failed to respond, counsel for the petitioning creditors nevertheless on September 7, 1976, delivered copies of the original petition to the Clerk and paid the requisite filing fee. Judge Werker was so advised. Thereafter Judge Werker, in a memo dated September 15, 1976, returned the appeal (undecided) to the Clerk of the Bankruptcy Court citing the apparent filing of a Chapter X petition which operated as an automatic stay of all matters in the pending bankruptcy proceeding, (App. App. p 32). The Clerk of the District

Court then refused to acknowledge that a Chapter X petition had been filed because the original had never been delivered to him. In fact the original Chapter X petition was at that moment in the possession of Judge Werker as an exhibit on the REAEMCO appeal. Thus at that moment of time, as a result of the foregoing, the bankruptcy proceeding was stayed by operation of law, but the Chapter X proceeding was not moving forward i.e. because the Clerk had never received the original petition as required by the Rules and therefore could not refer it to a District Judge. Counsel for the Trustee attempted to take up the matter with the presiding judge. The presiding judge indicated that the matter was in the hands of the Clerk of the Court. Subsequently, on September 22, 1976, following a conference between the Clerk of of the Court, Trustee's counsel, Appellant's counsel and Judge Milton Pollack (then presiding in the Motion Part) a copy of the original petition was filed by the Clerk at the express direction of Judge Milton Pollack to treat the copy as an original. This was accomplished over the strenuous objection of Appellants' counsel who asserted that only his motion to appoint a receiver should be considered. The Clerk of the Court then assigned the matter to Judge Lloyd F. Mac Mahon.

Shortly before Judge Pollack ordered the Clerk to treat the duplicate Chapter X petition as an original for filing, counsel for the petitioning creditors had made an application for the appointment of a receiver before Judge Galgay allegedly to effect an orderly transition from the bankruptcy to the Chapter X

proceeding (App. App. p. 57). Since Local Rule 8 requires that such a motion be made before the District Court (not the Bankruptcy Court) the motion was denied by Judge Galgay without prejudice to it being brought before the District Judge to whom the Chapter X petition would ultimately be referred.

The matter of the appointment of a receiver was additionally referred to Honorable Lloyd F. MacMahon District Judge. Judge Mac Mahon then remanded all matters to Bankruptcy Judge Galgay to hear and report on the issues. Judge Galgay conducted such hearing on September 27, 1976. (App. App. pp. 84-201).

At this hearing Appellant offered the testimony of Mr. Nogg referred to above, (1) to show the possibilities for reorganizing REA successfully (App. App. p. 125), (2) for Mr. Nogg to testify what Mr. Nogg did as the Chapter X Trustee of Yale Express, (Id)., (3) for the purpose of Mr. Nogg to testify that Mr. Sowerwine had stated that he had a conflict of interest, (Id). p. 126, (4) for Mr. Nogg would testify that since the Alltrans hearing, Mr. Nogg had had conversations with certain govenmental agencies in Washington, which led Mr. Nogg to believe that if REA were put into a Chapter X proceeding, there might be available to it certain federal funds or loan guarantees, (Id. p. 126), (5) that Mr. Nogg would testify that his proposals for reactivating the Bankrupts within the bankruptcy proceeding had been made to the Trustee and his

counsel. (Id. p. 125-133). Judge Galgay rejected that offer of testimony, (Id. p. 133).

Appellants then offered the testimony of Mr. Dermott Noonan, a certified public accountant for the purpose of proving that the files of the Bankruptcy Court were in chaotic condition; that the classification by the Bankruptcy Court of names of creditors was improper, and that the computer company used by the Bankruptcy Court in Kansas City neglected to include 4,162 proofs of claim, (App. App. pp. 135-136) and therefore a Receiver was necessary to straighten out the files of the Bankruptcy Court. (App. App. p. 137). Judge Galgay rejected that testimony.

Appellants then offered the testimony of Mr. Devlin for the purpose of showing that Mr. Devlin heard the Trustee state on at least two occasions that he believed that he had a conflict of interest; that all of the BRAC employees would support the Chapter X petition and the application for a Receiver, and that he believed that if the Chapter X petition was granted federal agencies in Washington would favorably reply to requests for funding, (App. App. pp. 139-140).

Appellants' counsel also offered a memorandum of Tom Kole, former president of the Bankrupts, dated February 1, 1976, and a memorandum from one R. Miller to the Trustee dated March 25, 1976, presumably expressing opinions that a Chapter X might be worked out, (App. App. p. 129) The offered exhibits are found

in App. App. pp. 202-215. The testimony of neither Messrs. Kole nor Miller was offered. Judge Galgay rejected the offered exhibits. It is on the basis of the rejection of this testimony and exhibits that Appellants and Intervenor take the position that Appellants were denied a fair hearing.

At the conclusion of this hearing Judge Galgay determined that the Chapter X proceeding was not filed in good faith (App. App. p. 132), in that it was unreasonable to expect that a plan of reorganization could be effected (App. App. p. 321), that the interests of the creditors would be best subserved in the present bankruptcy proceeding, and that the Chapter X petition was not filed in good faith under general equity principles. (App. App. p. 323). Judge Galgay's determination was expressly stated to be based on the detailed knowledge of the Bankrupts which he possessed by reason of multiple hearings and proceedings which took place before him during the entire period of these proceedings which commenced on February 18, 1975. (App. App. pp. 315, 316). Judge Galgay requested that counsel for the Trustee submit findings of fact and conclusions of law (reproduced in Interventor's Appendix). Following Judge Galgay's report to Judge MacMahon dated September 28, 1976 a hearing was then held before Judge MacMahon on September 29, 1976. On September 30, 1976 Judge MacMahon handed down his opinion and order adopting the findings of fact and conclusions of law of the Bankruptcy Court in all respects. Judge MacMahon's opinion is also found in Intervenor's Appendix. From this order Appellants appealed to this Court.

Intervenor has filed a brief in support of Appellant's position.

STATEMENT OF FACTS RELATING ONLY TO WHETHER A CONFLICT OF INTEREST QUESTION HAS BEEN PROPERLY RAISED

Appellants and Intervenor take the position that an issue with respect to possible conflict of interest by the Trustee was properly raised by them and should have been determined by the Court adversely to the Trustee. It is the position of the Trustee-Appellee, and the decision of the court, below. that no such issue was ever properly raised. If, however, this Court should determine that such issue was properly raised, then Trustee-Appellee's position (discussed later in this brief) is that this Court should remand the matter back to the Bankruptcy Court for a hearing of such issue on notice to all creditors. The legal argument on this position is found in Point IV of this brief. Therefore we will confine this separate section of the Facts to 1) whether that issue was properly raised and we will give the Court a few background facts to put Appellants' accusations in proper perspective.

Appellants' counsel were retained as special counsel to the Trustee, effective November 7, 1975, by order dated January 14, 1976. Such retention specifically included "analysis and preservation of the bankrupts'operating rights as an asset of the estate in contemplation of the sale of those rights." (Trustee's App. p.131, 134). Such retention included permitting appellants' counsel to remain physically in the Trustee's offices free of rent, telephone, electricity, secretarial and library facilities the costs of all of which were to be borne by

the Trustee. It should be mentioned in passing that Arthur M. Wisehart,Esq. a member of Wisehart, Friou ' Koch, Appellants' counsel previously had been on the staff of REA and then became house counsel to REA. Arthur Wisehart, Esq. was and is a stockholder of the Bankrupt REA Holding Corporation, the parent of the other three Bankrupts, and the firm of Wisehart & Koch predecessor to Wisehart, Friou & Koch had been general counsel to the Bankrupts before the Chapter XI and special counsel to the Debtors-in-Possession, all prior to his retention as special counsel the the Trustee. (Trustee's App. p. 136).

Appellant's counsel also represents REAEMCO, and represents the Chapter X petitioning creditors, who seek to appoint a receiver in the place of the Trustee and, with respect to the disqualification motion made by the Trustee, represents itself.

Most important, at a hearing before the Bankruptcy Court on November 17, 1976, F. Ralp Nogg, mentioned earlier as Appellants' chief witness at the Alltrans hearings, testified specifially that he had retained Appellants' counsel on behalf of the BRAC employees on March 24, 1976. The significance of this date is due to of the fact that on April 13, 1976 the Trustee, who had no knowledge whatsoever of such retention, asked Appellants' counsel to prepare an opinion letter as to whether the Trusee had any debilitating conflict of interest. This issue arose basically because the Trustee owned less than one-tenth of one percent of the shares of Shearson Hayden Stone, Inc. ("Shear-

son"), a large publicly held company, and the Trustee was an officer of such company. After his qualification, the Trustee had caused a special inquiry to be made at Shearson and he then ascertained that its railroad department, over which he had no supervision and as to the details of which he had no prior knowledge, had rendered certain services to certain railroads who were defendants in pending litigation with the Bankrupts. Appellants' counsel had contingent fee arrangements with the Bankrupts because they acted as counsel for the plaintiff Bankrupts asserting claims against these same railroads and others, -the so-called "major litigations". In each of those actions decided to date, a determination has been reached adverse to the bankrupts, including the recent decision of this Court in the "Notes" case (1976).

It was not until April 20, 1976 that the Trustee first authorized Appellants' counsel to act on behalf of REAEMCO, the company described above for the benefit of the BRAC (Intervenor) employees who were making an offer for the operating rights, to complete the written preparation of the REAEMCO offer so that it might be submitted by Trustee's general counsel to the Bankruptcy Court for a hearing. If REAEMCO turned out to be the successful bidder at the hearing on the sale of the operating authorities, then Appellants' counsel were authorized to represent REAEMCO at the closing.

On May 6 and 11, 1976, Appellants' counsel opined that the Trustee had a debilitating conflict of interest. When

the Trustee became aware of that opinion, he moved for an order authorizing him to retain a wholly independent law firm, Windels & Marx, to render an opinion on the conflict issue, because Appellants' counsel, by May 6, 1976 the date of their opinion letter had become a vociferous and determined adversary because Alltrans had submitted a bid substantially better than REAEMCO's, which fact was known to Appellants' counsel at the time they rendered their opinions on May 6 and May 11, 1976. It should also be noted that Appellant's counsel had obtained from the Bankrupt and from the Debtor-in-Possession an agreement giving Appellant's counsel contingent fees of up to 10% of the recoveries in the "major litigations" just mentioned. Appellants' counsel had insisted over the strenuous objection of the Trustee that the "major litigations" be turned over to REAEMCO for 25% of the net recoveries.

At the hearing on the motion to authorize Windels & Marx to render an independent conflict issue opinion, Appellant's counsel not only violently opposed the retention of Windels & Marx without even requesting authorization to do so from the Trustee, but also retained an attorney by the name of Frederick Cuccia, Esq., as special counsel to themselves to oppose such motion. Later, when testifying under oath as to whom Appellants' counsel represented when they opposed the Trustee's motion, to retain Windels & Marx they replied that they represented the Trustee. (Trustee's App. p.121, 122). The Bankruptcy Court granted the motion to permit the Trustee to retain Windels & Marx.

Windels & Marx filed a written opinion letter dated July 30, 1976 opining that the Trustee had no conflict. This letter is omitted from Appellants' Appendix, but because we deem it irrelevant to this appeal we hve not included it in our appendix.

Appellant's counsel without requesting authorization from the Trustee, but claiming to represent the Trustee, moved to strike the Trustee's reply brief submitted on behalf of the Trustee in connection with the Windels & Marx retention. By sheer coincidence, the return day of that motion to strike the reply brief fell on one of the days of the Alltrans hearings. Judge Galgay refused to consider it on the ground that it would confuse the issue as to who the successful bidder should be. (Trustee's App. p. 84). Because these statements were made at the Alltrans hearing in connection with the motion to strike, Appellants' counsel took the position that the conflict of interest issue had been properly raised at the Alltrans hearings, and Appellants' counsel, then acting as REAEMCO's counsel and on appeal to Judge Werker, not only included all of their letters with respect to the so-called conflict of interest issue in their record on appeal but, in addition, Mr. Friou, of Appellants' counsel, prepared a lengthy affidavit attacking a member of the Windels & Marx opinion and that affidavit, never previously seen by anyone or submitted to any court, was certified as part of the record to Judge Werker by Appellant's counsel. In addition, Appellants' counsel took Mr. Friou's affidavit together with the

letters of May 6 and May 11, 1976, and mailed them to all parties who had ever appeared in the Alltrans hearings, even though no party at those hearings except REAEMCO, represented by Appellant's counsel, had taken any appeal.

At the pre-argument hearing before Judge Werker, Trustee's counsel objected to this procedure and insisted that the conflict issue was not before Judge Werker on appeal. At that point, the following colloquy occurred:

> THE COURT: The method for raising a question of conflict is to make a motion to disqualify the trustee. Has that ever been done?
>
> MR. FRIOU: There has been no motion, your Honor.
>
> (Trustee's App. p. 123)

As a result, except for the oral motion referred to in Appellant's brief and the motion for the appointment of a receiver, no motion to remove the Trustee has ever been made by Appellant's counsel or by any other creditor. Appellants' counsel had opined that such conflict existed on May 6, 1976 and yet they failed to ever make a proper motion in this regard. It should also be noted that no one but Appellant's counsel, and now Intervenor, has ever mentioned the so-called "conflicts" issue despite circulation of the materials just described. This improper distribution of materials is one of the subject of the disqualification proceedings pending below.

POINT I

NEITHER APPELLANT NOR INTERVENOR CONTESTS THE CONCLUSION OF LAW OF THE BANKRUPTCY COURT ADOPTED BY THE DISTRICT COURT THAT THE CHAPTER X PETITION WAS NOT FILED IN GOOD FAITH UNDER GENERAL EQUITY PRINCIPLES. SINCE NONE OF THE EXCLUDED TESTIMONY RELATES TO THIS ISSUE, THIS COURT NEED NOT REACH ANY OF THE ISSUES RAISED BY APPELLANTS OR INTERVENOR TO AFFIRM THE DECISION BELOW.

Intervenor, in its brief, (page 12), concedes that it is not arguing on this appeal that the findings of the court below are not supported by the evidence. Intervenor, and Appellant in Point I of its brief, only argue that Appellants were deprived of a fair hearing in that the testimony of Messrs. Nogg, Noonan and Devlin and the written memoranda of Messrs. Kole and Miller were excluded. The conclusion of law of the Bankruptcy Court (which was adopted by the District Court) that under general equity principles this Chapter X petition was not filed in good faith, is not assailed either by Intervenor or Appellant and the excluded testimony on the hearing below, which Appellants and Intervenor argue as the basis for reversal, would be wholly irrelevant on that issue.

Bankruptcy Act §§141, 142 and 143 (11 U.S.C. §543, 544, 545)

> Sec. 141. Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.
>
> Sec. 142. If an answer is not filed by a debtor to a petition against it, or if the answer filed does not controvert any material allegation of the petition,

the judge shall enter an order approving the petition if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Sec. 143. If the answer of a debtor shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issue presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Rule 10-113 sets forth the same requirement of "good faith" for both voluntary and involuntary petitions.

Section 146 (11 U.S.C. 546) delineates the standards for when a petition is deemed not to have been filed in good faith.

"Sec. 146. Without limiting the generality of the meaning of the term 'good faith' a petition shall be deemed not to be filed in good faith if --
(1) the petitioning creditors have acquired their claims for the purpose of filing the petition; or
(2) adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act; or
(3) it is unreasonable to expect that a plan of reorganization can be effected; or
(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding." (Emphasis supplied).

It is important to note that items 1 through 4 set forth four specific instances when a Chapter X petition must be deemed not to have been filed in good faith; but, as the statute points out, these are not intended to limit the generality of the meaning of "good faith", which definition therefore includes "good faith" in

the general equity sense since the Bankruptcy Court is a court of equity, Bank of Marin v. England, 385 U.S. 99 17 L.Ed. 2d 197 (1966).

It is undisputed that the Chapter X petition was executed solely by employees, who, Mr. Olick opined, had claims which were valid only for the period prior to the Chapter XI, (supra, p.82) We have already pointed out in the facts, and Intervenor has conceded on page 3 of its brief that during the Chapter XI period, the Bankrupt lost at least $15,790,000 and that unpaid administration expenses of the Chapter XI period were in the neighborhood of $19,000,000. We have also mentioned that the funds presently in the hands of the Trustee aggregate only $7,000,000. Depending on whether or not sufficient funds are realized from the sale of the operating rights, it appears that there will be insufficient funds to pay even the Chapter XI administration claims in full. Intervenor concedes this at page 12 of its brief, where it states:

> "However, the basic facts are undisputed that at the present time the REA estate is not sufficient enough to pay fully the administration expenses, let alone begin to pay the creditors' pre-administration expenses."

Consequently, this petition has been filed by persons who seek to put at risk the $7,000,000 presently in the hands of the Trustee, which $7,000,000 belongs rightfully to the Chapter XI administration creditors - in short, to put other people's money at risk on the remote chance that enough profits will be made to pay some money over to them. Moreover, they seek this expenditure of funds only because REAEMCO, of which they would be actual or

beneficial owners, was not the successful bidder at the sale. If REAEMCO had been the successful bidder the the petitioning creditors expressed their willingness to withdraw (or not file) the Chapter X petition. (Trustee's App. pp. 126, 127).

It is also relevant on the issue of good faith on equity principals to note that the testimony offered in support of the REAEMCO proposal showed that not one penny of capital was committed to the REAEMCO operation, not one written commitment for any terminals or trucks had as yet been secured, (Trustee's App. 131-133) and not one valid assignment of one proof of claim from any single employee had been executed by the time of the hearings, i.e. June 23, 1976 to July 9, 1976. (Trustee's App. p. 128-130).

We are forced to conclude that the Chapter X petition was filed primarily as a threat to the Court, i.e. that unless REAEMCO became the successful bidder REAEMCO would be in a position to delay if not destroy the effect of the approval of the sale of the operating authorities to any other competitive bidder and, by so doing, deprive all the other creditors of the benefits of the sale of these rights to a viable company, which sale could result in a minimum payment to the estate of $9,600,000 subject only to ICC approval.

We must also note that the Appellants' counsel was counsel for REAEMCO and the petitioners who have filed this petition. They were counsel for both the Debtors and the Debtors-in-Possession. They were special counsel to the Trustee. They

assert a large pecuniary interest in the recoveries from certain lawsuits. They have attacked the Trustee elected by the general creditor body as being improperly elected and having improperly served because of conflicts of interest, and demand in their Chapter X petition that "an independent trustee" be selected. All of these activities by Appellants' counsel speak for themselves.

Assuming, arguendo, that Messrs. Nogg, Noonan and Devlin had been permitted to testify before the Bankruptcy Court, what possible testimony could any of the three of them have given which could change these undisputed facts. How could the opinion of any of them as to how successful the reorganization might be or whether the Trustee had ever stated that he had a conflict of interest change the fact that the petitioning creditors are seeking to put at risk other creditors' money to which the petitioning creditors have no claim. Obviously these undisputed facts present an unanswerable argument and Appellants and Intervenor have therefore remained silent on this issue.

It is clear, however, that on this basis alone, this Court should affirm the decision of the District Court that this petition was not filed in good faith under general equity principles.

POINT II

APPELLANTS WERE AFFORDED A FAIR HEARING

In support of the assertion that Appellants were denied a fair hearing, Appellants' brief merely states that had Mr. Nogg been permitted to testify he would have testified that the reorganization of the Bankrupts would have been feasible. Appellants then quote from some Congressional report, never offered before at any hearing or part of any record in these proceedings, to the effect that Chapter X would more likely result in continued operations by REA than conventional bankruptcy proceedings, (Appellants Brief, p. 15), a conclusion with which no one could disagree. We need not take the time of the court to respond to these comments.

Intervenor's brief, however, discusses this point more fully. On page 10 of its brief Intervenor "respectfully submits that the analysis required by Section 146(3) of the Act, 11 U.S.C. §546(3), is different and a rejection of the REAEMCO proposal does not necessarily mean that "it is unresonable to expect that a plan of reorganization can be effected ****". In this connection Intervenor points to the memoranda of Kole and Miller which were not admitted into evidence. Lastly Intervenor argues that the Bankruptcy Court erroneously refused to consider evidence to establish that the pending bankruptcy proceeding

would not best subserve the interests of REA creditors and stockholders.

It is true that rejection of the REAEMCO proposal does not per se mean that a plan can not be effected. It does mean, however, that the Court had already found as a fact that the Alltrans bid was better for the creditors. The shareholders had no further interest in the proceeding since the Bankrupts were insolvent. Their equity no longer existed. Consequently, the whole point of the filing of the Chapter X was to force the Court and the Trustee to swallow the REAEMCO proposal, whether or not the REAEMCO proposal was in the best interests of creditors. The determination of which proposal was in the best interests of creditors was a matter to be determined by the Trustee and the Court, not Appellants' counsel nor Intervenor. On this basis alone, the petition could not have been filed in good faith.

Moreover, of more significance is the nature of the testimony which Nogg would have given. The only difference between acceptance of the REAEMCO proposal and the proposed Chapter X proceeding was that in the proposed Chapter X other creditors money would be put at risk, not the petitioning creditors' money. The infinite details of the precise growth and development of the "new" express business was described by Nogg for over three and one half days. Numerous exhibits and charts were introduced to show the precise flow of income and

expenses. What other testimony could Mr. Nogg have given if he had been permitted to testify? Surely he would not have recanted everything or even anything he had said at the REAEMCO hearings. Since his testimony described every facet of the proposed new express business, his testimony could only have been repetitive.

Even Appellents' counsel could not think of anything specific. He merely stated (App. App P. 125) "I expect to elicit from Mr. Nogg testimony concerning not the REAEMCO proposal as such, Your Honor, but the possibilities for reorganizing REA successfully in its present situation." Obviously in view of the detailed tesimony of Nogg earlier, these words had no meaning.

The remainder of the testimony offered and rejected was either wholly inadmissable or of no probative value,- what Nogg did when he was Trustee of Yale Express in the handling of claims, (App. app. p. 125); that the Trustee stated to Nogg that he had a conflict of interest, (Id. p. 126), that the Trustee told Mr. Nogg that he was without transporatation experience (Id. p. 125); Mr. Nogg's opinion that the Bankrupts can be successfully reorganized (Id. p. 127); and Mr. Nogg's belief that if the Chapter X petition were granted the availability of federal funds or loan guarantees would be a distinct possibility (Id. p. 132). We submit the aggregate probative value of all this testimony would be zero.

Mr. Noonan's testimony was offered for the purpose of showing that the proofs of claim filed in the Bankruptcy Court were in a chaotic condition (App. App. 135), that 4,162 Proofs of Claim had names that had never been forwarded to the computer company (Id. p. 136), that when Mr. Nogg was Chapter X trustee in Yale Express he had personally handled each claim and responded to each claim (Id. p. 137). We decline to comment on the probative value of this testimony with respect to whether the Bankrupts can be successfully reorganized.

The remaining testimony was that of Mr. Devlin, who was not present, but whose testimony was offered for the purpose of stating that he heard the Trustee state that he had a conflict, that all of the employee creditors support a Chapter X and the appointment of a receiver, and that federal agencies would look favorably upon requests for funding, (Id. p. 139-140). We again offer no comment.

Finally, Appellant offered two written memoranda, one by Mr. Kole, who had been President of the Debtor for the last four years and directed the Debtors operations during the Chapter XI when the Debtor lost over $15,000,000 and who asked for the adjudication because the Debtor ran out of funds, and one by Mr. Miller, who had been Operations Vice President of the Debtor during the same period. Both memoranda were written after the adjudication of Bankrupts and both express the author's views as to how a reinstitution of an express business could be attempted.

The tesimony of neither Kole nor Miller was offered. Under those circumstances, the court below was correct in excluding the memoranda. Indeed the failure of Appellants to call either Mr. Kole or Mr. Miller during the Alltrans hearings, we submit, is of significance.

It is therefore apparent that the only testimony which was excluded by the lower court was either repetitive, of no probative value or inadmissable and consequently Appellants were accorded a fair hearing.

Appellants do not cite any cases or statutes as authority for the claim that the right to a fair hearing was in some way infringed. Intervenor cites, inter alia, the case of In Re Church E. Gates & Co., 97 F. 2d 911 (2d Cir. 1938) which is clearly distinguishable. In Re Church dealt with the dismissal of a petition under a prior statute, Bankruptcy Act §77B, where the Court did not even allow the petitioners to show "what the plan might have been." 97 F. 2d at 921. This is clearly different from the instant situation where Judge Galgay had listened to extensive testimony as to the proposed plan over seven days of the Alltrans hearings and was familiar with the testimony Appellants offered.

POINT III

THE CHAPTER X PETITION WAS NOT FILED IN GOOD FAITH UNDER §146(3) or §146(4) OF THE BANKRUPTCY ACT BECAUSE THE FACTS ARE OVERWHELMING THAT A REORGANIZATION COULD NOT POSSIBLY BE EFFECTED

> "SEC. 146. Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if -- ***
>
> (3) It is unreasonable to expect that a plan of reorganization can be effected or
>
> (4) A prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

It is self-evident that Congress enacted Sections 141, 143 and 146, to safeguard the rights of creditors by preventing petitioners from utilizing reorganization proceedings to hinder or delay parties in interest whose rights would best be subserved in other proceedings in state or federal courts, Section 146(4), or in proceedings where there is little or no prospect for a successful reorganization of the corporation, Section 146(3). The fact that Chapter X, was not designed or intended for use by the hopelessly insolvent corporation has been consistently reiterated. In re Tennessee Publishing Co., 81 F. 2d 462 (6th Cir.), aff'd sub nom, Tennessee Publishing Co. v. American National Bank, 299

U.S. 18, 81 L. Ed. 13 (1936); Goodman v. Michael, 280 F.2d 106 (1st Cir. 1960); Price v. Spokane Silver & Lead Co., 97 F. 2d 237 (8th Cir.), cert. den. 305 U.S. 626, 83 L. Ed. 401 (1938); and 6 Collier, Bankruptcy (14th Ed. 1969) at p. 1048 and cases therein cited. In the Price case, supra, the Court of Appeals for the Eighth Circuit construed the intent of Congress in the following manner:

> "We think it also may be safely said that it was not the intention of Congress in enacting §77B to place crutches under corporate cripples, fit subjects for liquidation, and send them out into the business world to be a menace to all who might purchase their securities or deal with them on credit." [At p. 247 of 97 F. 2d]

A similar expression or interpretation of Congressional intent may be found in the decision by the Court of Appeals for the Sixth Circuit in the Tennessee Publishing case, supra,

> "We think it clear, however, in agreement with the Second Circuit, that something more than sincerity of intention was intended. The purpose of the statute is to relieve distressed debtor corporations and to provide the mechanics for reorganization where reasonable expectations of continued useful existence may be fairly entertained. This being so, something more must be demonstrated by the debtor than mere honesty or sincerity of purpose. If not, then the way is open to the exploitation of every involved corporation by visionaries whose illusory and optimistic imaginations outrun their business judgments, and the interest of every legitimate creditor is at the mercy of debtors whose sole hope of financial salvation is an abiding faith in miracles." [81 F. 2d at p. 466].

The principles inherent in the aforementioned decision

were affirmed by the United States Supreme Court in the case of Tennessee Publishing Co. v. American Nat. Bank, supra:

> "However honest in its efforts the debtor may be, and however sincere its motives, the District Court is not bound to clog its docket with visionary or impracticable schemes for resuscitation." [299 U.S. 18 at 22; 81 L. Ed. 13 at 15].

Consequently, a hopelessly involvent debtor whose financial condition has deteriorated to the point that liquidation is the only feasible alternative must be deemed to have filed its petition for reorganization without the requisite "good faith" and "the petition must be dismissed as not filed in good faith". 6 Collier, Bankruptcy, supra, at p. 1048.

The broad principles enunciated in the cases cited above have been construed in a number of cases to constitute sufficient grounds for the dismissal of Chapter X petitions. For example, the mere fact that a debtor no longer has any assets at the time of the filing of its petition, or that the assets have been sold or transferred resulting in a fund for distribution to creditors, or that the debtor no longer has any business to reorganize have each been held to be sufficient grounds for the dismissal of a petition. Seaboard Terminals Corp. v. Western Maryland Ry. Co., 108 F. 2d 911, 916 (4th Cir. 1940); In re Ware Metal Products, Inc. 42 F. Supp. 538 (D. Mass. 1941); In re Valhalla Cemetary, 32 F. Supp. 616 (E.D.N.Y. 1940); and In re Electric Public Service Co., 9 F. Supp. 128 (D. Del. 1934). The

last mentioned case presented a set of facts closely paralleling those of the within proceedings. All of the assets of the debtor had been sold by a receiver in a Chancery Court proceeding and, at the time of the commencement of the reorganization proceeding the receivers held $24,000 in cash as the only asset of the debtor's estate. The petiton for reorganization was dismissed with the following pertinent comment:

> "It thus apears that no plan of reorganization can be worked out. It would be futile to take the steps required by section 77B. A possibility of reorganization must exist to meet the test of good faith." [9 F. Supp. at p. 128].

Section 77B was replaced by Chapter X by virtue of the passage by Congress of the Chandler Act in 1938. The standards for invoking the relief of corporate reorganization, however, were similiar.

Where the debtor has little or no equity in whatever property it may have, the same result follows, i.e. the petition for reorganization should be dismissed and liquidation be had either in ordinary bankruptcy proceedings or in foreclosure proceedings, if pending, in a state court. Marine Harbor Properties, Inc. v Manufacturer's Trust Co., 317 U.S. 78, 87 L. Ed. 64 (1942); San Francisco Laundry Assn. v. American Trust Co., 127 F. 2d 187 (9th Circ. 1942); Chapman Bros. Co. v. Security First Nat. Bank, 111 F. 2d 86 (9th Cir.), cert. den. 311 U.S. 652, 85 L. Ed. 417 (1940); Provident Mut. Life Ins. Co. v. University Ev. L. Church. 90 F. 2d 992 (9th Cir. 1937); Ogelsby & Simpson Supply Co. v. Duggan, 174 F. 2d 904 (8th Cir.

1949); Breeding Motor Fr. Lines v. Reconstruction Finance Corp., 172 F. 2d 416 (10th Circ. 1949); and In re St. Charles Hotel Co., 60 F. Supp. 322 (D.N.J. 1945), aff'd 149 F. 2d 645 (3rd Cir.), cert. den. 326 U.S. 738, 90 L. Ed. 440 (1945).

In San Francisco Laundry, supra, the petition for reorganization was dismissed by the District Court upon a finding that neither the debtor nor its unsecured creditors had any equity in its assets which consisted of two parcels of real property. The indebtedness collateralized by the real property exceeded the value of the property. The Court of Appeals for the Ninth Circuit affirmed the findings of the District Court with the following conclusion:

> "The conclusion reached below was that its value is substantially less than the obligation secured; and the finding has ample support in the record. In the light of this finding and the admitted situation otherwise, it is plain that the debtor is insolvent in the bankruptcy sense; and that there is no reason to expect that a reorganization can be effected. Hence the proceeding was not instituted in good faith, §146(3) of the Act, 11 U.S.C.A. §546(3), and the dismiss was proper, §144, 11 U.S.C.A. §544." [At p. 188 of 127 F. 2d]

The findings of the District Court were likewise confirmed by the Court of Appeals for this Circuit in Chapman Bros. Co. v. Security-First Nat. Bank, supra, dismissing the petition for reorganization. Those findings, recited in the decision of the Court of Appeals for the Ninth Circuit included, inter alia, the following:

> "*** the indebtedness of the debtor corporation exceeded its assets by over a million dollars; that the [debtor] was hopelessly insolvent; its net loss for the 14 months preceding the filing of the petition was $140,957.76 and for the prior years was as alleged in the answer of the Security-First National Bank of Los Angeles. Upon these specific findings the Court concluded that appellant's petition was not made in good faith, that 'it was unreasonable for the debtor corporation to expect that any plan of reorganization could be effect'. The court dismissed the petition***."
> [111 F. 2d at p. 87].

As noted above, the order of the Court of Appeals affirmed the decision of the District Court.

Appellant's case here, for all practical purposes relied entirely on the testimony of Mr. Nogg. Judge Galgay heard Mr. Nogg for three and one-half days. In his memorandum opinion and order authorizing the Trustee to accept the Alltrans offer for the operating rights, while acknowledging Mr. Nogg's credentials and his enthusiasm, stated

> "I am not persuanded that his projections and predictions are solid enough to justify the court's embracing the REAEMCO proposal. I find great difficulties in accepting his position that there are large numbers of express customers who will give their patronage to REAEMCO forthwith or that competitors who filled the void when REA went out of business would surrender those customers without a fight." (App. App. pp. 28-29).

Judge Galgay went on to hold,

> "6. That it would be adverse to the interests of the bankrupt estate that any assets of the bankrupt presently in the hands of the Trustee be put at risk to enable the Trustee to continue to expand an express business, other than the continued operation of the REXCO division by the Trustee pending the final disposition of the Property."

Judge MacMahon adopted Judge Galgay's findings.

We submit that Judge Galgay, who had first hand opportunity to judge not only the credibility of Mr. Nogg on his plans to resurrect the Bankrupt into a full scale express company, but the testimony of all witnesses and parties at all hearings since February 18, 1975, found that the interests of the bankrupt estate would be best served by selling the operating rights and completing the liquidation process.

The evidence against a successful reorganization of REA is simply overwhelming. In less than ten months in a Chapter XI arrangement proceeding REA, which at that time had a full complement of employees, trucks and terminals, managed to lose 15.7 million dollars, and, with the exception of 1974 the debtor lost money in the express business in every year for the last 30 years. The Trustee in Bankruptcy has been liquidating REA's assets pursuant to authority vested in him by the Bankruptcy Act for close to a year. He has sold all of the trucks, closed practically all of the terminals, reduced the payroll to only employees essential to proper administration of the estate, including collecting claims, and has ceased all operations. Through his efforts, the Trustee has on hand approximately $7 million dollars. This sum is exclusive of the money he will receive from the sale of the operating rights to Alltrans. Under any conceivable concept of law or equity the first claim upon these liquidation monies belongs to the unfortunate body which consists of the creditors of the aborted Chapter XI proceeding.

A Chapter X proceeding would put these funds at risk and thus cannot be sanctioned.

The testimony at trial indicated that $10,000,000 would be a conservative estimate of working capital required to hold any reasonable expectation that a resurrected express company would be successful. The petitioners would have the Court authorize a Chapter X trustee to expend the bankrupt estate's liquidation fund of approximately $7,000,000 to reorganize a practically fully liquidated company on the expectation that a reorganization trustee could succeed where others have failed for years and, we must add, failed badly, even with the protection of a Chapter XI proceeding. There is simply no expectation that a successful reorganization of the debtor's express business could take place; therefore, the petition must be dismissed as having not been filed in good faith under §143(3) of the Bankruptcy Act. Indeed, Intervenor concedes this on page 12 of its brief.

The conclusions of law of Judge Galgay as adopted by the District Court were therefore correct and should be affirmed.

POINT IV

THE ISSUE OF THE TRUSTEE'S ALLEGED CONFLICT OF INTEREST BY THE TRUSTEE HAS NEVER BEEN PROPERLY RAISED.

The procedure for the removal of a trustee is clearly established in Bankruptcy Rule 221, which states in part:

> "(a) Removal for Cause. On application of any party in interest or on the court's own initiative and after hearing on notice, the court may remove a trustee or receiver for cause and appoint a successor." (Emphasis added).

Section 2a(17) of the Bankruptcy Act gives the bankruptcy courts the jursidiction to "Approve the appointment of trustees by creditors or appoint trustees when creditors fail to do so; and upon complaints of creditors or upon their own motion, remove for cause receivers or trustees upon hearing after notice;" (Emphasis supplied.)

We have pointed out in the "Statement of Facts" that Appellants' counsel admitted before Judge Werker on August 24, 1976 that no such motion had been made. Appellants' brief makes the same concession on page 40 in stating: "The key motion made before the Bankruptcy Court on the record on September 27, 1976 was not a motion to remove the Trustee but a motion to disqualify him and his counsel from acting and appearing on behalf of the bankrupt estate in Chapter X proceedings." Appellants' counsel therefore acknowledges that they never made such a motion, the only way in which the issue could be raised. At the hearing on the remand before Judge Galgay, Appellants' counsel (App. App. p. 27) made an oral motion to disqualify the Trustee

Federal Rules of Civil Procedure, on which such counsel rely as proof of having made such a motion. Such a motion, however, can only be granted upon hearing after notice and, since no notice was given, no hearing could be held, and consequently Rule 7 is inapplicable. The courts below, therefore, were correct in holding that this issue had never properly been raised.

We submit that the failure by Appellants' counsel to properly raise such issue is deliberate. Such counsel knows that if the issue were raised it would be decided adversely to them. For their purposes it is better not to have such a decision but to inject the question into every other issue in this proceeding to cast shadows or doubts and to keep alive a weapon which can always be trotted out to show that any decision of the Bankruptcy Court which disagrees with Appellants' counsel was wrong, prejudiced or even corrupt. This conclusion is illustrated by the following exchange before Judge Werker on August 24, 1976 at the pre-argument hearing on the appeal from the order awarding Alltrans the rights:

> THE COURT: The method for raising a question of conflict is to make a motion to disqualify the trustee. Has that even been done?
>
> MR. FRIOU; There has been no motion, your Honor.
>
> THE COURT: If there has been no motion then the question is: How can it be raised here?
>
> MR. FRIOU: The Court can raise it itself. It is pervasive on the credibility issue.

> THE COURT: I would like to listen to you as to how it can be raised on appeal if the motion has never been made.
>
> MR. FRIOU: The credibility of the trustee is completely at issue in this proceeding in the first place.
>
> * * * *
>
> That may not be a motion to disqualify, but it comes as close to it as I know how to make it without going the extra step.
>
> Trustee's App. pp. 123, 124, 125

Without conceding that the issue of so-called "conflict of interest" was raised, we note that the citation of authority relied on by Appellants to prove that the Trustee-Appellee had a debilitating conflict are entirely inapposite.

The Appellants cite Cinema 5, Ltd. v. Cinerama, Inc. 528 F. 2d 1348 (2d Cir. 1976). This case involved the disqualification of an attorney from taking part in litigation between two of this clients. Ironically, Cinema 5 is one of the key precedents cited by the Trustee in the motion, now awaiting decision by Judge Galgay, to disqualify the Appellants' counsel from partaking in litigations against the Trustee because Appellants' counsel was, and still is, under retainer as special counsel to the Trustee. This case bears no resemblance to the case at bar.

The Appellants also cite In Re Freeport Italian Bakery, Inc. 340 F. 2d 50 (2d Cir. 1965) and Meredith v. Thralls, 144 F. 2d 473 (2d Cir. 1944) in connection with their assertion that their motion "was not a motion to remove the Trustee, but a motion

to disqualify him and his counsel from acting and appearing on behalf of the bankrupt estate in Chapter X proceedings." (App. Brief p. 40). That this is a distinction without a difference is clear because Trustee cannot be bifurcated so as to destroy the Trustee's freedom and authority to protect the Chapter XI creditors from any attempt to institute a Chapter X proceeding for the benefit of a class of creditors who have interests subordinate to the Chapter XI creditors. The Trustee representsl all creditors and must protect the creditor body generally from demands of particular creditors. In any event, the Freeport and Meredith cases are inapplicable. Freeport dealt with the removal of a Trustee who (1) was closely related to the principals of the bankrupt and its major creditors, (2) had defrauded other creditors by concealing his own claims, (3) had filed an exaggerated claim on his own behalf and on behalf of his mother-in-law, and (4) had not fulfilled his duty as trustee to press all legitimate claims of the estate. The Trustee in Freeport was obviously acting in a manner bordernf on the criminal. surely a very different from even the unfounded allegations made by Appellants' counsel about the Trustee. The Trustee has not committed nor is he accused of any wrong-doing or negligence in his trusteeship.

Meredith v. Thralls, supra is equally inapposite because it dealt with a Chapter X trustee who was ineligible because he was an officer of the debtor's parent company as well as some of its creditors. Moreover, it dealt with an operating trustee under Chapter X.

Similarly, the Appellants cite U.S. v. Carrigan, _____F.2d__, discussed at N.Y.L.J. November 8, 1976, p. 1, where the trial judge in a criminal trial was admonished for not acting sua sponte on a conflict of interest where one lawyer represented multiple criminal defendants whose interests diverged. The relevance of this criminal case is, to be kind, obscure.

The Appellants cite Galfand v. Chestnut Corporation, F. 2d, at N.Y.L.J. November 19, 1976, p. 1, for the proposition that a fiduciary owes duties to his beneficiaries. No one would disagree with that proposition, but Galfand dealt with the relation of investment advisors to shareholders in a mutual fund, a relation which "is fraught with potential conflicts of interest." The relation, which is strictly governed by the Investment Company Amendments Act of 1970, 15 U.S.C. 80a-35 (b) was abused in Galfand by an advisor who made false and misleading statements in proxy material to obtain shareholder approval. No such allegation has been made here.

Appellants also cite Mosser v. Darrow, 341 U.S. 267, 95 L. Ed. 927 (1951). In Mosser, a reorganization trustee was held personally liable for profits because he allowed his employees to deal in the securities of the debtor for their own purposes and counter to the interests of the debtor. No further comment is needed.

To further bolster the allegations of conflict, Appellants on page 39 of their brief quote from "Document No. 8 in the Appendix to Petitioners Pre-Hearing Memorandum." (App. Brief

p. 36). The "pre-hearing" refers to the pre-hearing argument before Juge Werker on August 24, 1976. The "Document No. 8" is Appellant's counsel's own brief and, suffice to say, the description of events contained on pages 37-39 of Appellants' brief hears no resemblance to the facts or reality.

The decision below that the conflicts of interest question was never properly raised should be affirmed.

POINT V

THE ISSUE OF ALLEGED CONFLICTS OF INTERESTS IS NOT RELEVANT IN A DETERMINATION OF GOOD FAITH FOR THE PURPOSES OF A PETITION UNDER CHAPTER X

The alleged conflict of interest issue is irrelevant in a determination as to whether a petition for reorganiztion under Chapter X is filed in good faith. Section 146 of the Bankruptcy Act, as set forth above in Point One, defines the scope of the term "good faith" as used in Section 141, also set forth above in Point One.

The elements which are considered by the Court in determining good faith relate to the good faith of the petitioners. There is neither a statutory authority nor a logical need to inquire into the qualifications of the Trustee in a hearing on whether a Chapter X petition is filed in good faith, particularly when such issue of the Trustee's alleged conflicts have never been properly raised.

As we pointed out in Points I, III and IV, a judge may not approve a petition unless satisfied that is was filed in "good faith". Consequently, it makes no difference whether any answer is filed by the Trustee in Bankruptcy, the Debtor or any other person. The court may make such a determination on its own. Therefore, even assuming, arguendo, that Judge Galgay should have disqualified the Trustee and his counsel from participating in the hearings on Chapter X; it could not affect his determin-

ation which was based on the multiple hearings, financial data and exhibits which had been presented to him since February 18, 1975, up to the date of the filing of the Chapter X proceedings.

We submit that Judge Galgay's conclusions of law, both 1 and 2, that the Chapter X petition was not filed in good faith in that it was unreasonable to expect that a plan of reorganization could be effected and that the interests of creditors would be best subserved in the pending proceeding were clearly correct, and Judge MacMahon's decision adopting such conclusions should be in all respects affirmed.

POINT VI

THE COURT BELOW WAS CORRECT IN DENYING THE MOTION FOR THE APPOINTMENT OF A RECEIVER

The grounds asserted by Appellants for the appointment of a receiver were that a receiver is necessary for an orderly transition to a Chapter X Trustee (App. App. p. 55-59) that the present Trustee has a conflict of interest (App. App. p.57), and to alleviate the jeopardy into which the rights have been placed by their sale to Alltrans. (App. App. p.59).

It is hard to imagine how better to achieve a disorderly transition, if the Chapter X petitions were to be granted, than to put in a new administation for a very short time between the present Trustee and the Chapter X Trustee. Obviously, the most orderly transition could be accomplished if the present Trustee, who knows all of the assets, liabilities, personnel, and other relevant facts who has personally lived through more than one year of liquidation of the Bankrupts, remained until his successor were appointed.

Since the conflict question was never raised and the "jeopardy" to the rights alleged by Appellants consists of having sold them to a bidder other than REAEMCO, pursuant to an order of the Court, we need not comment futher on this argument.

POINT VII

THE ISSUES PRESENTLY PENDING BEFORE THE INTERSTATE COMMERCE COMMISSION ("ICC") ARE NOT BEFORE THIS COURT AND ANY REFERENCES TO SUCH ISSUES IN APPELLANTS' BRIEF AND APPENDIX SHOULD BE DISREGARDED

During the Chapter XI proceeding, the Debtor-in-Possession, REA Express, Inc., ("REA"), in its continuing attempts to become profitable, instituted, among other things, the REXCO division operation. The REXCO division was a special commodities express operation which handled only full trailer load traffic. It was a logical addition to and a very small part of REA's express business in 1975. In brief, REA, through commission agents (7%) located throughout the United States, arranged for the transportation of full trailer loads of traffic by owner-operators (75%) of tractor trailers. Such movements were made under REA control based upon REA's operating authorities. REA utilized the remaining 18% of the gross income for insurance, administrative costs and profit. At the time of its adjudication, it had to embargo all express traffic. The Trustee determined that the REXCO division was the only profitable division of REA and, with the approval of the Bankruptcy Court, continued the REXCO division in operation, having discussed the matter with representatives of the ICC and others, with a view to maintaining his position that the operating rights of REA were alive and could be sold as an asset of the estate despite the adjudication in bankruptcy.

The entire motor carrier industry, spearheaded by the American Trucking Associations, Inc., commenced numerous actions before the ICC to close down the REXCO division and, even more important, cancel REA's operating authorities.

The REAEMCO proposal relied heavily on the continuation of the REXCO division because it was profitable and could supply working capital to REAEMCO which had been unable to obtain working capital from other sources. The Alltrans proposal, on the other hand, was to acquire REA's operating authorities, subject to ICC approval, even if the REXCO division operations terminated.

On November 17, 1976, long after Appellants appealed to this Court and while this appeal was pending, the ICC issued a Report and Order which declared the REXCO division operations to be illegal and, even more important, revoked REA's important temporary operating authority and dismissed the related proceeding to make that authority permanent. The Trustee has obtained from this Court a stay of the ICC Report and Order in REA Express, Inc. et al v. United States and Interstate Commerce Commission, United States Court of Appeals, Second Circuit, Docket No. 76-4278.

If the ICC decision is not overturned, that fact alone would destroy any possibility that the REAEMCO proposal would have ever been a viable proposal and, in addition, would require a Chapter X Trustee to rely exclusively on the approximately seven million dollars of creditors' money currently in the

hands of the Trustee-Appellee. The Alltrans proposal, on the other hand, could still result in the acquisition of REA's operating authorities by Alltrans even if the REXCO division was finally determined to be illegal, so long as REA's important temporary operating authority was not revoked and the proceeding to convert it into permanent authority was not dismissed.

We submit, however, that this entire matter is outside of the scope of these proceedings, the essential events occurred after the execution of the order appealed from herein and, at this time, these issues are presently pending before the ICC and before this Court in another proceeding, Docket 76-4278, supra. We have added this point to our brief solely because Appellants' brief, pages 9 and 10, quotes extensively from the opinion of the ICC in a manner designed to suggest that the Trustee has acted improperly and is incompetent. It should also be noted here that Alltrans, uncertain about the validity of the REXCO division operations, specifically provided in their approved offer to purchase the REA operating authorities that the declaration of the invalidity of the REXCO division operations by the ICC would not result in their withdrawing their offer to purchase REA's operating authority. The REAEMCO proposal, as stated above, was entirely dependent on the validity of a continuing REXCO division operation.

For all the reasons stated above, including, specifically, the existence of Docket 76-4278, this subject matter is not now before this Court in this proceeding.

CONCLUSION

1. Neither Appellants nor Intervenor contests the conclusion of law of the Bankruptcy Court adopted by the District Court that the Chapter X petition was not filed in good faith under general equity principles. Since none of the excluded testimony relates to this issue, this Court need not reach any of the issues raised by Appellants or Intervenor to affirm the decision below.

2. Appellants were afforded a fair hearing.

3. The Chapter X petition was not filed in good faith under §146(3) or §146(4) of the Bankruptcy Act because the facts are overwhelming that a reorganization could not possibly be effected.

4. The issue of conflict of interest by the Trustee has never been properly raised.

5. The issue of alleged conflicts of interest is not relevant in a determination of good faith for the purposes of a petition under Chapter X.

6. The Court below was correct in denying the motion for the appointment of a receiver.

7. The issues presently pending before the Interstate Commerce Commission are not before this Court and any references to such issues in Appellants' brief and appendix should be disregarded.

8. The decision below of Judge MacMahon, adopting the

findings of fact and conclusions of law reported by Judge Galgay, should be affirmed in all respects.

Dated: New York, New York
January 31, 1977

Respectfully submitted,

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